

VZCZCXRO1275

PP RUEHAG RUEHDE RUEHKUK RUEHROV

DE RUEHLB #1337/01 2560718

ZNY CCCCC ZZH

P 120718Z SEP 08

FM AMEMBASSY BEIRUT

TO RUEHC/SECSTATE WASHDC PRIORITY 3010

INFO RUEHEE/ARAB LEAGUE COLLECTIVE

RUCNMEM/EU MEMBER STATES COLLECTIVE

RUEATRS/DEPT OF TREASURY WASHDC

RUCNDT/USMISSION USUN NEW YORK 2892

RUEHNO/USMISSION USNATO 3112

RHMFIASS/CDR USCENTCOM MACDILL AFB FL

RHEHAAA/NSC WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 BEIRUT 001337

SIPDIS

DEPT FOR NEA/FO, NEA/ELA

ALSO FOR EEB/FO DSULLIVAN, EEB/ODF DEMARCELLUS

USUN FOR KHALILZAD/WOLFF/SCHEDLBAUER

NSC FOR ABRAMS/RAMCHAND/YERGER/MCDERMOTT

STATE PASS TO USAID FOR LAUDATO/BEVER/SCOTT

E.O. 12958: DECL: 09/12/2018

TAGS: ECON ELAB EFIN ENRG PGOV PREL SA EG LE

SUBJECT: LEBANON: FINANCE MINISTER FOCUSED ON BUDGET

SUPPORT, NOT KEEN ON CASH TRANSFER REPROGRAMMING

Classified By: Ambassador Michele J. Sison for reasons 1.4
(b) and (d).

SUMMARY

¶1. (C) Finance Minister Mohamad Chatah told USAID Deputy Assistant Administrator James Bever and the Ambassador that budget support is his number one priority. He discussed the pros and cons of the cabinet's recent approval of a higher minimum wage, and said he planned to ask the IMF for a new Emergency Post-Conflict Assistance (EPCA) agreement during the upcoming World Bank/IMF meetings in Washington. He also outlined the Prime Minister's plans to reinvigorate development projects left dormant during the long political stalemate in Lebanon.

¶2. (C) Chatah said that to replace the gas excise tax condition for disbursement of a tranche of the USG cash transfer pledged at Paris III, he would like to see a condition related to structural reforms in the telecom, IT, or power sectors, rather than one based strictly on budgetary criteria. He said Telecom Minister Bassil wants to privatize mobile telecoms early, well in advance of the spring 2009 parliamentary elections. He described plans to restructure electricity tariffs to bring in more revenues and rationalize consumption, and highlighted the importance for Lebanon of securing electricity, oil, and gas supplies from its neighbors. While he did not reject the idea of reprogramming a portion of the cash transfer for assistance projects ahead of the 2009 elections, after two months as Finance Minister, Chatah was not particularly keen on the idea either. End summary.

BUDGET PROBLEMS

¶3. (C) The Ambassador, USAID Deputy Assistant Administrator James Bever, Acting AID Director, and EconOff called on Finance Minister Mohamad Chatah in his ministry office September 10. Chatah made it clear that budget support was his top priority, though he was pessimistic about being able to make any improvements over the next eight months in Lebanon's budget or debt position. He said that if Lebanon's GDP growth were running at six to seven percent per year instead of four to five percent as it is now, he would be able to maintain the current debt to GDP ratio, but in the near term, he expected that ratio to worsen. Referring to a

Saudi pledge of one billion dollars in development loans for Lebanon, Chatah said he wanted to ask that at least half of that go into budget support, "if the Saudis ever deliver it".

(Note: This is a separate issue from the never-delivered Saudi promise to provide a \$1 billion deposit at Lebanon's Central Bank. End note.)

14. (SBU) Chatah noted that the new minimum wage increase approved by the Council of Ministers September 9 would worsen the GOL's budget situation, costing approximately 500 million dollars annually. Nonetheless, he said, he had convinced the cabinet to approve four measures that would help compensate for these costs, as part of the minimum wage package: 1) a tax increase from 5 percent to 7 percent on interest income, 2) elimination of part of a VAT exemption on schools and hospitals, 3) collection of fees and taxes on illegal beach resorts and seafront developments, and 4) a tax of two percent on corporations' revaluation of assets. Revenues from these measures would cover about half the cost of the new minimum wage, said Chatah, though there would still be a significant increase in the deficit.

15. (C) In addition to the fiscal challenges of the minimum wage, Chatah said he had had a hard time defending the increase to Lebanon's industrialists, who, as a result of the cabinet decision, will have to increase their workers' salaries as well. Chatah admitted that he sympathized with them, especially given the market conditions in Lebanon, particularly the rising cost of electricity, which is already several times more expensive in Lebanon than it is in other countries in the region. "Companies are picking up everyday

BEIRUT 00001337 002 OF 004

and moving to the Gulf, where they have cheaper energy and cheaper labor and can export to Lebanon," he said. "We are losing jobs." Nonetheless, he said, there had been no minimum wage adjustment in Lebanon since 1996, so this increase was due.

16. (SBU) In his continued push to shore up finances, Chatah said he planned to request another EPCA agreement from the IMF during his trip to Washington for the annual World Bank/IMF meetings in October. Lebanon's first EPCA, agreed after the 2006 Israel-Hizballah war, expired at the end of 2007.

"IS THIS THE TIME TO THINK BIG?"

17. (SBU) Chatah said that Prime Minister Siniora had decided to lead a serious effort to start a new economic push in Lebanon. Chatah said Siniora wants to move forward on two development projects in Beirut that had been dormant since the 2006 war, and that he hoped these would attract big investment from the Gulf countries. Siniora also wants to push ahead on encouraging private investment in the Tripoli economic zone and upgrading the airport, and he has plans to make progress on an IT/media sector project in the south.

18. (SBU) With such a short time before the 2009 parliamentary elections, "is this the time to think big?" asked Chatah rhetorically. Even if it is not, he said, that is the way the PM thinks. According to Chatah, Siniora thinks some of these projects can attract big investment from the Gulf states, and that they could be convinced to divert some of their investment into social projects, particularly those in line with Paris III commitments, in other parts of Lebanon, so ensure that everyone benefits.

USG CASH TRANSFER AND ELECTRICITY SECTOR REFORM

19. (C) The Ambassador brought up the USG cash transfer support for payment of Lebanese debt, agreed upon at the Paris III conference in 2007. She asked what the Minister's thoughts were on what would be an appropriate replacement for

the adjustment of gas excise tax (a politically infeasible option in the current economic and political climate) as a condition for the release of one of the two tranches of the transfer yet to be disbursed. While reiterating his focus on budget support, Chatah stressed that he did not want a condition attached to budget or debt targets, given the difficulties he had just laid out in making progress on that front in the next year. He said he wanted to see conditionality attached to structural reforms, perhaps in the telecom, IT, or power sector.

¶10. (C) Chatah said that Telecom Minister Gebran Bassil was anxious to carry out the telecom privatization as soon as possible, but certainly well in advance of the parliamentary elections. Bassil wants the political fallout of privatization to be cleared up before election season.

¶11. (SBU) In terms of the power sector, Minister Chatah pointed out that electricity is the single largest drain on the national budget, because of a combination of production inefficiencies and subsidies. He cited Minister of Energy Alain Tabourian's claim that Electricite du Liban (EDL), Lebanon's state power utility, is running a two billion dollar annual deficit. Chatah said Tabourian had not been taking into account the effect of upcoming reforms on that number, and Chatah believed they had the potential to improve the revenue numbers.

¶12. (SBU) Chatah said he and Tabourian had discussed putting in place a new tariff structure at EDL that would charge higher rates for higher usage. Tabourian had believed that a new meter system would be necessary for implementation of the new rate structure, but Chatah said he had found a way to implement it now. He said that under the new plan, the 70 percent of Lebanese whose consumption fell under 500 kwh per month would see no change in their monthly bill; their rate

BEIRUT 00001337 003 OF 004

would remain at the current subsidized rate. However, any consumption above that quantity would result in the consumer paying a higher tariff on the entirety of his or her consumption, not merely the margin above 500 kwh. For the biggest consumers, those using over 1000 kwh per month, the subsidy would be eliminated entirely, said Chatah.

¶13. (SBU) There would certainly be resistance from consumers, but Chatah hoped that a communication plan "so that people understand" might lessen the blow of the higher rates. In addition, the new rate structure would not apply to industrialists, though it will apply to small business.

THE KEY IS ENERGY

¶14. (SBU) Chatah said that the immediate challenge for Lebanon will be getting electricity and natural gas from Egypt, and oil from Iraq. He said the Egyptians offered to sell Lebanon electricity, but they still are trying to sell it to Lebanon at a cost based on production using fuel oil, instead of natural gas. This would result in Lebanon's paying several times more than the Egyptians or Jordanians pay for electricity.

¶15. (SBU) As for oil, Chatah said that during PM Siniora's August trip to Baghdad, the Iraqis had agreed to supply Lebanon with oil at the same subsidized price at which they sell to Jordan (a subsidy of 22 dollars per barrel), but while Jordan has oil refineries to process crude oil, Lebanon does not. He said the Lebanese would need to find a mechanism either to get Iraqi crude refined for them or swap their crude for refined oil before they could start buying from Iraq.

¶16. (SBU) Chatah said that PM Siniora had also worked with the Iraqis on a cooperation agreement and on ways or promoting private sector linkages. Chatah hoped that on PM's

next trip to Baghdad, he could bring private sector representatives with him.

"ALL I CARE ABOUT IS BUDGET SUPPORT"

¶17. (C) Throughout the meeting, Deputy Assistant Administrator Bever and the Ambassador probed Chatah about potential projects that would be useful for Lebanon in the coming months, perhaps in the areas of energy and water infrastructure. Chatah came back time and again with his number one priority: budget support. When discussing whether it would be appropriate or beneficial for the USG to target some of the cash transfer money (meant for budget support) for anything else. Chatah shrugged, "All I care about is budget support. If the Saudis come through with budget support, then you can do what you like."

¶18. (C) The Ambassador asked Chatah why the Saudis so far had not come through on their pledges for project loans and central bank deposits. Chatah replied that there was always a disconnect between the Saudis' political positions and their financial and economic actions. "Which is strange," said Chatah, "because they are all the same people." He suspected, however, that PM Siniora might have gone begging to the Saudi royals a few too many times. When he was an advisor to Siniora at the Grand Serail, he said, for a certain period, Siniora would call or send a letter to the Saudis every two or three days, asking for help on one thing or the other. "I think that might have backfired," said Chatah.

COMMENT

¶19. (C) Chatah mentioned two reforms that could potentially be used as a replacement condition for the gas excise tax adjustment. The first is the package of revenue-increasing measures he cited as part of the minimum wage decision that will act to offset losses from the wage increase. They show a continued commitment to Paris III reform. Nonetheless,

BEIRUT 00001337 004 OF 004

they are already completed, which we suspect may make them less palatable in Washington.

¶20. (C) Post recommends we move forward with the second reform, electricity tariff reform as the replacement condition, as a strong structural reform that will bring in revenues, rationalize energy consumption, and hopefully reduce losses as EDL. If Washington agencies agree with that recommendation, however, we would like to confirm with Chatah his agreement before proceeding further.

SISON